Office-Supre
F 1
MAY
CHARLES EL

In the Supreme Court
OF THE
United States

October Term, 1950

No. 7[redacted] 52

Nick W. Maroosis,
Petitioner,

vs.

James G. Smyth, United States Collector of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI
and
BRIEF IN SUPPORT THEREOF.

A. Russell Berti,
Mills Building, San Francisco 4, California,
Attorney for Petitioner.

Morris M. Grupp,
961 Mills Building, San Francisco 4, California,
Leon Schiller,
105 Montgomery Street, San Francisco 4, California,
Of Counsel.

Subject Index

Page

Petition for writ of certiorari 1

I.

The bases upon which it is contended that this court has jurisdiction to review the judgment of the Court of Appeals for the Ninth Circuit are:

(A) Statutory provisions 2

(B) Rules of court 2

(C) Date of judgment 2

II.

Statement of the case 3

III.

Questions presented 8

IV.

Special and important reasons relied upon for the allowance of the writ 9

Brief in support of petition for writ of certiorari 11

A. Opinions of the courts below 11

B. Jurisdiction 11

C. Statement of the case 12

D. Specification of errors 12

E. Summary of argument 13

F. Argument 15

1. The Court of Appeals erred in holding that a finding that two hundred cases of whiskey were moved to an unknown destination could be the basis of a six hundred-case assessment which is contrary to the spirit of the decision of the Supreme Court of the United States in Helvering v. Taylor, 293 U. S. 507, 55 S. Ct. 287, 79 L. Ed. 623, and to the general principle of law that an assess-

AUG 7 1953

200077

Page

ment must be based upon a rational foundation and that an assessment is illegal if it is baseless and arbitrary 15

2. The Court of Appeals erred in holding that the finding that two hundred cases of whiskey were moved to an unknown destination supported the the conclusion that the petitioner's books and accounts contained insufficient or improper entries 22

3. The Court of Appeals erred in ignoring the principle of law that when a taxpayer has presented competent and relevant evidence to support his position, the Commissioner can no longer rely upon the presumptive correctness of his determination as evidence of its correctness, either directly or as affecting the burden of proof, but rather the case must be decided upon the evidence presented by the taxpayer and the evidence presented by the Commissioner. This holding is contrary to the decisions of other courts of appeal. This principle of law, in the opinion of counsel, has never been passed upon by the Supreme Court of the United States 26

4. The Court of Appeals erred in holding that the fraud penalty was sustained by clear and convincing evidence 29

Conclusion 30

Table of Authorities Cited

Cases	Pages
Andrew v. Commissioner of Internal Revenue (C.C.A. 2) 135 F. (2d) 314	27
Budd v. Commissioner (C.C.A. 3) 43 F. (2d) 509	29
Crude Oil Corporation of America v. Commissioner of Internal Revenue (C.C.A. 10) 161 F. (2d) 809	27
E. Albrecht & Son v. Landy (C.C.A. 8) 114 F. (2d) 202	27
Griffiths v. Commissioner (C.C.A. 7) 50 F. (2d) 782	29
Helvering v. Taylor, 293 U. S. 507, 55 S. Ct. 287, 79 L. Ed. 623	12, 15, 20
Hemphill Schools Inc. v. Commissioner of Internal Revenue (C.C.A. 9) 137 F. (2d) 961	27
J. M. Perry v. Commissioner (C.C.A. 9) 120 F. (2d) 123	26
Jameson v. Commissioner (C.C.A. 5) 45 F. (2d) 4	29
Wiget v. Becker (C.C.A. 8) 84 F. (2d) 706	27

Statutes	
Judicial Code, Section 1254	2
28 U.S.C., Judiciary and Judicial Procedure, Section 2101	3
26 U.S.C.A., Section 2800(k)	3
26 U.S.C.A., par. 3612(d)(2)	6

Texts	
20 Am. Jur. 165	27

Rules	
Revised Rules of the Supreme Court, Rule 38, subdivision 5(b)	2

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1950

No.

NICK W. MAROOSIS,
Petitioner,

vs.

JAMES G. SMYTH, United States Collector of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

The petitioner, Nick W. Maroosis, respectfully petitions the Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit to review a judgment of said Court entered on February 9, 1951. In support of this petition, the petitioner avers:

I.

THE BASES UPON WHICH IT IS CONTENDED THAT THIS COURT HAS JURISDICTION TO REVIEW THE JUDGMENT OF THE COURT OF APPEALS FOR THE NINTH CIRCUIT ARE:

(A) Statutory provisions.

This Court has jurisdiction to issue a writ of certiorari to review the judgment in question under Section 1254 of the Judicial Code, which provides:

> "Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods: (1) By Writ of Certiorari granted upon the petition of any party in any civil or criminal case before or after rendition of judgment or decree; * * *"

(B) Rules of Court.

It is also provided under Subdivision 5(b) of Rule 38 of the Revised Rules of the Supreme Court that among the reasons which will be considered for the granting of a review on writ of certiorari is where one Court of Appeals has rendered a decision in conflict with another Court of Appeals in the same matter; or has decided an important question of federal law which has not been, but should be, settled by this Court; or has decided a federal question in a way probably in conflict with applicable decisions of this Court.

(C) Date of judgment.

The decision of the Court of Appeals sought to be reviewed was rendered on February 9, 1951. Petitioner filed a petition for rehearing, which was denied.

This petition for certiorari, the brief in support thereof, and the record in this case are being filed in this Court within ninety days after the entry of the judgment by the Court of Appeals, in accordance with Section 2101, Title 28, U. S. Code, Judiciary and Judicial Procedure.

II.

STATEMENT OF THE CASE.

On May 1, 1944, in conformity with Title 26 U.S.C.A., Sec. 2800(k), which imposes floor stock taxes on distilled spirits, the petitioner herein, Nick W. Maroosis, filed his return and paid the taxes in accordance therewith to James G. Smyth, U. S. Collector of Internal Revenue for the district (R. 321, 322).

The return reported 1330.36 proof gallons of distilled spirits on hand at April 1, 1944, the tax date (R. 322), in the Geary Street store owned by petitioner.

Hedrick, agent of respondent, testified that on the morning of March 31, 1944, the day prior to the date the taxpayer's inventory was taken, he and one Arisco, another employee of the Alcohol Tax Unit, while driving past the Geary Street store, observed a large canvas-covered truck parked at the front. About an hour later the truck was driven to the San Francisco warehouse where taxpayer's whisky was stored. A coupe, known by Hedrick to be associated with taxpayer's

store, came to the warehouse, and the driver of the truck and the driver of the coupe had a conference while the cartons were being loaded on the truck. The truck and coupe left the warehouse and drove into a garage near the waterfront. There, Hedrick and Arisco observed the transfer of the cartons from the large truck to a small black panel-bodied truck that was also parked in the garage. The panel truck left the garage and Hedrick followed it to the basement garage of a residence on San Bruno Avenue.

Hedrick then rejoined Arisco near the garage where the large truck was located. This truck proceeded to the Geary Street store where cartons were taken from the truck and loaded into automobiles parked at the curb. The truck then proceeded to the Fillmore Street store where the driver removed four hand-truck loads of cartons from the store and placed them on the truck. The truck was thereafter lost in traffic. Although Hedrick and Arisco continued to observe taxpayer's three liquor stores, none of the cartons appears to have been taken into any of the stores. The records of the truck rental agency revealed that the truck had been returned shortly after Hedrick and Arisco had lost sight of it (R. 325, 326).

The warehouse records set forth that petitioner or his agents drew two hundred cases of Three Rivers Whisky from the warehouse on March 31, 1944 (R. 222).

Respondent's agents were therefore suspicious of petitioner.

Because of this suspicion, respondent's agents checked the Geary Street inventory on April 1, 1944 (R. 235, 240).

On May 2, 1944, respondent's agents took their own physical inventory of the Geary Street store (R. 240, 241). This inventory was adjusted back to April 1, 1944, and on comparison with petitioner's inventory reflected an over-declaration of inventory by petitioner in the amount of 108.98 proof gallons (R. 244, 245).

The collector's agents then chose to disregard the previous spot check and their own May 2, 1944, physical inventory and to compute an inventory as of April 1, 1944, to check the accuracy of petitioner's reported physical inventory.

The collector determined from a previous floor stock tax return, petitioner's opening inventory of distilled spirits on November 1, 1942. The collector's agent, Hedrick, ascertained the amount of distilled spirits purchased by taxpayer from November 1, 1942, to March 31, 1944, by examination of the records of wholesale liquor dealers (R. 323). The purchases determined by the agent were $41.00 *less* than those reflected in petitioner's books, and Hedrick admitted he could have missed an invoice during the check of wholesalers' records which could have accounted for the $41.00 difference (R. 265, 266).

During the same period, petitioner's gross sales amounted to $276,328.51 as reflected by his records (R. 323, 66).

In order to compute the distilled spirits on hand on April 1, 1944, it was necessary to determine what portion of the gross sales during the said period was distilled spirits sales. Agent Hedrick therefore asked the petitioner what percentage of his total sales was distilled spirits sales. Petitioner gave two answers at the same meeting. At first he said 66%, and later he said 86% of his gross sales was distilled spirits sales (R. 253). The agent accepted the 86% figure and concluded that in dollar sales petitioner sold $230,-770.88 of distilled spirits during the period, or 11,-023.46 proof gallons of distilled spirits (R. 323, 324). Deducting this 11,023.46 from the amount of the inventory plus the purchases from November 1, 1942, to March 31, 1944, respondent concluded that 2,553.21 proof gallons were on hand on April 1, 1944, and that the petitioner had thus under-declared his inventory in the amount of 1,222.85 proof gallons on his tax return (R. 324).

This alleged under-declaration of 1,222.85 proof gallons was used as the basis for the additional assessment by the collector, and a 50% penalty was added under the authority of Title 26 U.S.C.A., par. 3612(d)(2).

Petitioner sold the Geary Street store on May 25, 1944, just twenty-three days after respondent took his physical inventory of petitioner's stock (R. 102).

On May 25, 1944, the State Board of Equalization of the State of California conducted an audit of the sales of distilled spirits of the Geary Street store (R.

103, 104, 105, copy of audit, Plaintiff's Exhibit 21, in evidence).

This actual audit of sales from petitioner's books disclosed that the percentage of gross sales which constituted sales of distilled spirits was 96.41% instead of 86% as estimated by the petitioner (Plaintiff's Exhibit 21, in evidence, Exhibit A to plaintiff's complaint, R. 18).

On November 9, 1945, before the assessment in dispute was paid by petitioner, a copy of the said State Board of Equalization audit, which discloses on its face how the 96.41% figure was reached, was mailed to the Alcoholic Tax Unit together with a letter of the same date (Plaintiff's Exhibit 26, in evidence).

Notwithstanding that respondent had a copy of said audit in its possession since November 9, 1945, respondent's agent Hedrick testified that he never saw the audit until two weeks before the trial (November 16, 1949). For four years said audit was in possession of respondent without ever being seen by the agent who had developed the assessment here in issue. Said agent admitted that he did not even check that audit to determine its correctness (R. 268).

A certified public accountant, J. Bruck, was called as a witness by petitioner. His qualifications as a certified public accountant were accepted by the attorney for the respondent (R. 164).

He testified that petitioner kept a double-entry set of books which in his opinion were complete and properly kept and that from an examination of the

records of petitioner he could determine petitioner's purchases, sales and his inventory as of a given period (R. 165).

He further testified that he reviewed the method by which the State Board of Equalization arrived at the 96.41% of distilled spirits sales and that their computations were in order and in the witness' opinion were substantially correct (R. 171); that his check showed the correctness of said audit (R. 172).

The witness Bruck further testified that the permanent records of the petitioner were in evidence in this case as Plaintiff's Exhibit 14 (R. 181) and Plaintiff's Exhibit 17 (R. 205). There is no evidence in the record to contradict Mr. Bruck's testimony as above set out.

III.

QUESTIONS PRESENTED.

1. Whether upon proof of so-called suspicious circumstances or upon the inability of a taxpayer to disprove the existence of a specified under-declaration of tax, the Bureau of Internal Revenue is thus allowed to make any assessment it desires to make subject to no limitation or criterion other than the mere whim of the assessing agent?

2. Whether the decision of the various Courts of Appeal, in cases appealed from the Tax Court of the United States, that the presumption of correctness of an assessment by the Bureau of Internal Revenue is a

presumption of law applies equally to a case arising in a District Court of the United States?

3. Whether an assessment made upon an estimate of the taxpayer is legal merely because it is his estimate even if the evidence in the case establishes that the estimate is wrong?

IV.

SPECIAL AND IMPORTANT REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

1. A wholly arbitrary and excessive assessment has been levied in this case and has been sustained by the Court of Appeals for the Ninth Circuit, which arbitrary and excessive assessment is in conflict with the rule of law established by the Supreme Court of the United States, which condemns as illegal any arbitrary and excessive assessment.

2. The Court of Appeals for the Ninth Circuit has ruled in effect that the presumption of correctness of the finding of the Bureau of Internal Revenue is a presumption of fact in a District Court proceeding which is in apparent conflict with decisions of Courts of Appeals in other circuits.

3. The Supreme Court of the United States has not decided whether the presumption of correctness of the finding of the Bureau of Internal Revenue is a presumption of law or a presumption of fact.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the

seal of the Supreme Court of the United States directed to the United States Court of Appeals for the Ninth Circuit, commanding said last mentioned Court to certify and send to the above entitled Court for its review and determination a full and complete transcript of the record and proceedings in the case entitled on its docket: "Nick W. Maroosis, Appellant, vs. James G. Smyth, United States Collector of Internal Revenue, Appellee," No. 12530, and that this Court review and decide the questions presented according to law and reverse the judgment of the United States Court of Appeals for the Ninth Circuit entered in said cause and that your petitioner may have such other and further relief as to this Court may seem meet and just and in conformity with law.

Dated, San Francisco, California,
May 2, 1951.

A. RUSSELL BERTI,
Attorney for Petitioner.

MORRIS M. GRUPP,
LEON SCHILLER,
Of Counsel.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1950

No.

NICK W. MAROOSIS,
Petitioner,

vs.

JAMES G. SMYTH, United States Collector of Internal Revenue,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A. OPINIONS OF THE COURTS BELOW.

The opinion of the District Court has not been reported. For the opinion of the Court of Appeals see R. 321 et seq.

B. JURISDICTION.

The grounds on which the jurisdiction of the Supreme Court of the United States is invoked are set forth supra at page 2.

C. STATEMENT OF THE CASE.

The facts are set forth supra at page 3.

D. SPECIFICATION OF ERRORS.

The Court of Appeals erred in

1. Holding that a finding that two hundred cases of whisky were moved to an unknown destination could be the basis of a six hundred-case assessment, which is contrary to the spirit of the decision of the Supreme Court of the United States in *Helvering v. Taylor,* 293 U.S. 507, 55 S. Ct. 287, 79 L. Ed. 623, and to the general principle of law that an assessment must be based upon a rational foundation and that an assessment is illegal if it is baseless and arbitrary.

2. Holding that the finding that two hundred cases of whisky were moved to an unknown destination supported the conclusion that the petitioner's books and accounts contained insufficient or improper entries.

3. Ignoring the principle of law that when a taxpayer has presented competent and relevant evidence to support his position, the Commissioner can no longer rely upon the presumptive correctness either directly or as affecting the burden of proof, but rather the case must be decided upon the evidence presented by the taxpayer and the evidence presented by the Commissioner. This holding is contrary to the decisions of other Courts of Appeals. This principle of law, in the opinion of counsel, has never been passed upon by the Supreme Court of the United States.

4. Holding that the fraud penalty was sustained by clear and convincing evidence.

E. SUMMARY OF ARGUMENT.

The assessment in this case was made upon a formula devised by the Bureau of Internal Revenue. The only figure in question in that formula was the percentage of distilled spirits sales to total sales for the period July 1, 1943, to March 31, 1944. *Respondent contended 86% was proper because it was petitioner's estimate, and it resulted in an assessment.* Petitioner urged 96.41% should be used in the formula because it was correct. The Trial Court sustained the respondent on the ground that the petitioner had withdrawn two hundred cases of whisky from the warehouse on March 31, 1944, which in the opinion of the Trial Court were not reported. Petitioner denies that the two hundred cases were not reported, but concedes the propriety of a primary assessment on said two hundred cases so as not to bring a purely factual question before the Supreme Court of the United States. However, petitioner insists it is illegal to assess a taxpayer for approximately six hundred cases of whisky based upon an incorrect formula merely because of a finding that he did not report two hundred cases. Hence, petitioner contends that the assessment is arbitrary and excessive, and therefore illegal.

Petitioner contends further that his books cannot be rejected on the basis of the two hundred cases of

whisky allegedly not reported, since obviously the books and records have nothing whatever to do with the question of whether the two hundred cases of liquor were reported or not. All the evidence in the case pertaining to the said books and records establishes that they were true, complete and correct records.

Petitioner contends that the presumption of correctness of findings of the Bureau of Internal Revenue is a presumption of law and not of fact. The decision of the Court of Appeals of the Ninth Circuit in this case indicated that it considered the correctness of findings of the Bureau of Internal Revenue a presumption of fact in a District Court proceeding. Petitioner contends that based on the evidence in this case, the 96.41% figure must be accepted as having been established by a preponderance of the evidence.

There is no evidence of fraud in this case, and most certainly respondent has not met his burden of proof by establishing by clear and convincing evidence the existence of fraud.

F. ARGUMENT.

1. **THE COURT OF APPEALS ERRED IN HOLDING THAT A FINDING THAT TWO HUNDRED CASES OF WHISKEY WERE MOVED TO AN UNKNOWN DESTINATION COULD BE THE BASIS OF A SIX HUNDRED-CASE ASSESSMENT WHICH IS CONTRARY TO THE SPIRIT OF THE DECISION OF THE SUPREME COURT OF THE UNITED STATES IN HELVERING v. TAYLOR, 293 U. S. 507, 55 S. CT. 287, 79 L. ED. 623, AND TO THE GENERAL PRINCIPLE OF LAW THAT AN ASSESSMENT MUST BE BASED UPON A RATIONAL FOUNDATION AND THAT AN ASSESSMENT IS ILLEGAL IF IT IS BASELESS AND ARBITRARY.**

Counsel for petitioner is presently of the opinion, and has always been of the opinion, that with the substitution of the 96.41% figure for the 86% figure in the calculated inventory formula, petitioner has sustained the accuracy of his physical inventory and fully accounted for all the merchandise purchased by him prior to April 1, 1944.

Counsel for petitioner is fully aware of the general rule that concurrent findings of fact by two courts below will not ordinarily be disturbed in the Supreme Court. Therefore, counsel for petitioner is willing to concede *that although we do not agree with the finding,* we are, however, bound by the finding that the two hundred cases of whisky moved from the warehouse on March 31, 1944, were not reported on the return filed on May 1, 1944.

However, two hundred cases of Three Rivers Whisky represents 412.80 proof gallons of whisky (a case of Three Rivers Whisky equals 2.064 gallons). The assessment in this case was based not on the two hundred cases of Three Rivers Whisky but on

a mathematical formula in which the question is the amount of distilled spirits sales during the period of November 1, 1942, to March 31, 1944. The assessment, based on the formula resulted in an alleged underdeclaration of 1,222.85 proof gallons.

A written stipulation between counsel was entered into and made a part of the record in this case, which stipulation is set forth on pages 26 to 29, inc. of the Transcript.

Paragraph 4 of the stipulation provides that if 96.41% is the correct percentage of distilled spirits sales to total sales between the period of July 1, 1943, to March 31, 1944, the distilled spirits sales would be $200,025.28. This stipulation is as follows:

> "That if the Court finds from the evidence that 96.41 percent of the gross sales between the period of July 1, 1943, to March 31, 1944, were sales of distilled spirits that the sales of distilled spirits for the preiod from July 1, 1943, to March 31, 1944, would be $200,025.28." (Tr. p. 27.)

Paragraph 6 of said stipulation provides that if the selling price per proof gallon was $20.93 the total of distilled spirits sales would then be 12,096.75 proof gallons instead of the 11,023.46 proof gallons listed in the assessment (Tr. p. 28).

This would result in a reduction of 1,073.29 proof gallons in the respondent's calculated understatement (Paragraph 8 of Stipulation R. 28) and would reduce that calculated understatement to 149.56 proof gallons (Paragraph 11 of Stipulation R. 28-29). Such

an alleged understatement of 149.56 proof gallons, as provided in paragraph 12 of said stipulation, would confirm the physical inventory taken by the petitioner, since it was stipulated in Paragraph 12 that an understatement or overstatement of approximately 1% of proof gallons purchased or sold during a given period based on a percentage calculation, is sufficient to confirm a physical inventory (R. p. 29).

(The selling price per proof gallon, $20.93, was computed by the respondent's agent by adding 33⅓% to the 15,695 cost price per proof gallon. 33⅓% was the average OPA mark-up. These figures have been accepted throughout by both parties.)

This stipulation can be summarized very briefly, as follows:

If 96.41% (The State Board of Equalization figure) of the total sales between July 1, 1943, and March 1, 1944 (an amount of $200,025.28) were distilled spirits sales, then the entire assessment here in question is in error and the inventory of appellant as of April 1, 1944, upon which the original return was based is accurate.

The issue in that formula is whether 86% or 96.41% of the sales during the period July 1, 1943, to March 31, 1944, were distilled spirits sales.

Respondent admits no check was made of petitioner's 86% estimate, although respondent's agent admitted that if this estimate was wrong, the entire assessment was wrong (R. 273).

Petitioner offered in evidence an audit of the California State Board of Equalization which showed that 96.41% of the sales between July 1, 1943, and March 31, 1944, were distilled spirits sales.

Appendix A, Schedule 1, of the Brief for Appellant, traced every figure in the State Board audit to the books in evidence before the trial Court.

The correctness of that audit and the fact that the books of the petitioner were complete and properly kept and in evidence before the Court was testified to by J. Bruck, the Certified Public Accountant, as set forth in detail in our brief above.

In the face of this evidence, the Trial Court sustained the use of the 86% on the grounds:

> "that such method was the most reasonable and rational one available to defendant under the circumstances, especially since because of the knowledge defendants had of the diversion of said two hundred cases of whisky mentioned in Finding of Fact III hereof defendant could have no confidence in any report by plaintiff" (R. 52, Finding of Fact VI).

The Court further said:

> "It is reasonable for Mr. Hedrick to accept that figure (referring to the 86% figure) accepting that he found that there was a substantial shortage of about twelve hundred proof gallons. That shortage corroborated what he himself had seen." (R. 302.)

The Court further said:

> "I felt that the problem would be whether or not the Government would be entitled to use 86% or whether it should have employed 96%, but although for a long time in the position of feeling that the defendant had a substantial burden, I was compelled by the later disclosure to conclude as I have announced." (R. 306)

The Court also said:

> "But regardless of the accounting system, regardless of the percentage figure that should, as a synthetic proposition, be employed in an estimate, the overwhelming evidence is at least two hundred cases of whisky were shunted other than to any of the three stores in which Maroosis was interested."

An examination of Finding VI of the comments of the Court quoted above make it overwhelmingly obvious that the Trial Court sustained the assessment purely on the basis of the two hundred cases moved from the warehouse on March 31 and that actually the Court gave no credence itself to the mathematical formula devised by the respondent's agents. In fact, the Court said:

> "It is difficult for me to see how the plaintiff can contend the 86% figure is unreasonable when he was the one that gave the figure. In using the figure 86%, Mr. Hedrick inclined as strongly as he could toward the plaintiff. Had he used 66%, the shortage would have been tremendously greater." (R. 303.)

This statement further makes it clear that the Court was prepared to sustain any percentage figure used by the respondent, that the Court never at any time considered the proper percentage figure to be used in the mathematical formula as one of the issues of the case. In short, the Court took the position that the movement of the two hundred cases of liquor from the warehouse on March 31 opened the petitioner in this case to whatever assessment Mr. Hedrick, agent of respondent, decided to levy.

The case of *Helvering v. Taylor,* 293 U.S. 507, 55 S. Ct. 287, 79 L. Ed. 623, involved the review of a judgment of the United States Circuit Court of Appeals for the Second Circuit, which judgment had reversed an order of the Federal Board of Tax Appeals.

In this case the Supreme Court expressed itself forcibly on the subject of arbitrary assessments. In speaking of proceedings before the Federal Board of Tax Appeals, now the United States Tax Court, the Supreme Court said at page 515:

> "But, where as in this case the taxpayer's evidence shows the commissioner's determination to be arbitrary and excessive, it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him. On the facts shown by the taxpayer in this case, the Board should have held the opportionment arbi-

trary and the commissioner's determination invalid."

The Supreme Court said on page 514 of that decision in regard to *actions to recover taxes paid* that:

> "Obviously the burden was on the plaintiff in order to establish a basis for judgment in his favor, specifically to show not merely that the assessment was erroneous but also the amount to which he was entitled."

Petitioner has met the burden of proof required by the Supreme Court.

Upon the basis of the testimony of respondent's agents, regarding the so-called truck movements, respondent grounded his right to make an assessment based upon a formula. The formula in turn was based, not on the testimony regarding the truck movements, but rather upon an estimate of distilled spirits sales during a period prior to March 31, 1944. Yet when the petitioner offers conclusive testimony that the estimated percentage of distilled spirits sales of 86% was incorrect and that 96.41% was correct, the respondent refuses to argue the merits as to the correct percentage to be used, but stubbornly persists that 86% should be used because it is supported by the so-called truck movements. This is a clear admission by the respondent that the formula cannot stand of its own weight. Said formula resulted in a 1222.85 proof gallon calculated under-declaration of inventory. Although the respondent's testimony regarding the truck movements does not state any number of cases, petitioner is willing to concede the respondent's authority to

assess him for the entire 412.8 proof gallons withdrawn from the warehouse on March 31, 1944. But the difference of 810.05 proof gallons (1222.85 less 412.8) is completely unsupported as a matter of law, and petitioner is entitled to a refund of the tax on 810.05 proof gallons and in addition any penalty and interest paid on this portion of the assessment.

To state the petitioner's position another way: If the truck movements support an assessment, the assessment should be based on said truck movements. If the formula devised by the respondent supports an assessment, the assessment should be made on the basis of said formula. However, for the Trial Court and the Court of Appeals to sustain the formula on the basis of the truck movements is arbitrary, baseless, and illegal.

---

2. THE COURT OF APPEALS ERRED IN HOLDING THAT THE FINDING THAT TWO HUNDRED CASES OF WHISKEY WERE MOVED TO AN UNKNOWN DESTINATION SUPPORTED THE CONCLUSION THAT THE PETITIONER'S BOOKS AND ACCOUNTS CONTAINED INSUFFICIENT OR IMPROPER ENTRIES.

A certified public accountant, J. Bruck, was called as a witness by petitioner. His qualifications as a certified public accountant were accepted by the attorney for the respondent (R. 164).

He testified that petitioner kept a double-entry set of books which in his opinion were complete and properly kept, and from an examination of the records of petitioner he could determine petitioner's

purchases, sales and inventory as of a given period (R. 165).

The report of the State Board of Equalization auditor contained the following reference:

"Records.

"1. Do records meet requirements of section 24.4 of the Alcohol Beverage Control Act and the Rules and Regulations issued thereunder?

"Yes." (R. 119.)

From the foregoing quotation, it could only be inferred that the records of petitioner were such as are required by law, from which records could be determined the percentage of distilled spirits sales against gross sales.

We included in the brief for petitioner Schedule I (appendix) *which schedule traced every figure in the State Board audit to the books and records of petitioner in evidence in this case,* and we cited the page numbers in said records to which each figure could be traced. Thus it is clear that the statement of the State Board of Equalization auditor regarding the completeness of the records referred to the records in evidence before this Court.

The only testimony offered by appellee regarding the books and records was the testimony of Mr. Hedrick. When Mr. Hedrick was questioned as to what books and records the average retail liquor dealer maintained that the petitioner did not maintain, he answered:

"I was getting cross up. I made a thorough investigation or thorough investigation *only of*

this particular liquor store. The other floor stock tax investigations that I made resulted in no complication that involved searching investigations. *I am unprepared to state from experience such as you have mentioned whether his records are more or less complete than other stores."* (R. 272.) (Italics ours.)

Furthermore, the appellee conducted only one audit procedure on the petitioner's records. An audit was made of the purchases from the records of the wholesale liquor dealers, and this audit substantiated the accuracy of petitioner's records.

The Government did not offer an expert accountant as a witness to support its position regarding the completeness of petitioner's books.

Thus the only reason offered by either the appellee or the Trial Court, and the only grounds suggested by the Court of Appeals for the conclusion that the books were inadequate or incomplete was the fact that the so-called *daily sales book* did not fully *itemize* all sales.

The witness Bruck testified that the permanent records of petitioner were in evidence in this case as Plaintiff's Exhibit 14 (R. p. 181) and Plaintiff's Exhibit 17 (R. p. 205). There is no evidence in the record to contradict this testimony. It is admitted by all parties, and the record shows, that the permanent records contained the *total sales for each day* and the *total sales for each month* and the *total sales for the entire period of the business.*

Appellee does not contend, and never has, that the permanent records of petitioner do not reflect the total sales for each and every day. In fact, appellee took the gross sales figure from the petitioner's books when the assessment was computed (R. 265). He now seeks to condemn those books because they reflect the total daily sales, but petitioner did not keep an *itemized list of each individual sale. There is no requirement of law, accounting principle or business practice* that would be served by the maintenance of a record of the type suggested by the appellee, by the Trial Court, or by the Court of Appeals.

Actually, the Trial Court chose to disregard the books of the petitioner on the same grounds that it sustained the entire assessment in this case, for the Trial Court stated in Finding of Fact VI (R. 52):

> "Because of the knowledge defendant had of the diversion of said two hundred cases of whisky mentioned in Finding of Fact III hereof, defendant could have no confidence in any report by plaintiff."

Thus we find that the testimony of appellee's agent with regard to the so-called truck movements is used as the basis for disregarding the books of the petitioner, although all evidence in the case clearly establishes that the petitioner's books and records are complete in every detail, are in order, and fully disclose all information required by law and by good bookkeeping practice needed to determine the correctness of petitioner's April 1, 1944, physical inventory.

3. **THE COURT OF APPEALS ERRED IN IGNORING THE PRINCIPLE OF LAW THAT WHEN A TAXPAYER HAS PRESENTED COMPETENT AND RELEVANT EVIDENCE TO SUPPORT HIS POSITION, THE COMMISSIONER CAN NO LONGER RELY UPON THE PRESUMPTIVE CORRECTNESS OF HIS DETERMINATION AS EVIDENCE OF ITS CORRECTNESS, EITHER DIRECTLY OR AS AFFECTING THE BURDEN OF PROOF, BUT RATHER THE CASE MUST BE DECIDED UPON THE EVIDENCE PRESENTED BY THE TAXPAYER AND THE EVIDENCE PRESENTED BY THE COMMISSIONER. THIS HOLDING IS CONTRARY TO THE DECISIONS OF OTHER COURTS OF APPEAL. THIS PRINCIPLE OF LAW, IN THE OPINION OF COUNSEL, HAS NEVER BEEN PASSED UPON BY THE SUPREME COURT OF THE UNITED STATES.**

In petitioner's Reply Brief to the United States Court of Appeals for the Ninth Circuit, petitioner cited a decision of that Court of Appeals in the case of *J. M. Perry v. Commissioner* (C.C.A. 9) 120 F. (2d) 123). The Court in that decision stated on page 124 with regard to findings of the Bureau of Internal Revenue:

> "This finding is presumptively correct, that is, until the taxpayer proceeds with competent and relevant evidence to support his position, the determination of the Commissioner stands. When such evidence has been adduced the issue depends wholly upon the evidence so adduced and the evidence to be adduced by the Commissioner. The Commissioner cannot rely upon his determination as evidence of its correctness either directly or as affecting the burden of proof. Welch v. Helvering, 290 U.S. 111, 115, 54 S. Ct. 8, 78 L. Ed. 212, Helvering v. National Grocery Co., 304 U.S. 282, 294, 295, 58 S. Ct. 932, 82 L. Ed. 1346; Helvering v. Talbot's Estate, 4 Circ., 1940, 116 F. (2d) 160, 162."

In its opinion in this case, however, the Court of Appeals rejected the decision as being not applicable to a suit for a tax refund (R. 328).

The principle cited in the case of *J. M. Perry v. Commissioner,* supra, has been stated by other Courts of Appeals. For example, in *Crude Oil Corporation of America v. Commissioner of Internal Revenue* (C.C.A. 10), 161 F. (2d) 809, the Court stated at page 810:

> "The presumption of the correctness of the Commissioner's findings is one of law. It is not an inference of fact. It disappears when evidence sufficient to sustain a contrary finding has been introduced."

Other cases from the Courts of Appeals citing this same principle of law are:

Hemphill Schools Inc. v. Commissioner of Internal Revenue (C.C.A. 9) 137 F. (2d) 961, 964;

Wiget v. Becker (C.C.A. 8) 84 F. (2d) 706, 708;

E. Albrecht & Son v. Landy (C.C.A. 8) 114 F. (2d) 202, 206;

Andrew v. Commissioner of Internal Revenue (C.C.A. 2) 135 F. (2d) 314, 317.

It is a fundamental rule of law that a presumption of law disappears when the opposing party offers evidence contrary to a presumption and the case then stands upon the facts and whatever inferences may be drawn therefrom (20 Am. Jur. 165).

In the opinion of counsel, the Court of Appeals in the instant case was wholly arbitrary in concluding

that the principles set forth in the above cases with regard to the nature of the presumption of correctness of findings by the Bureau of Internal Revenue are limited purely to a Tax Court proceeding and not to a District Court proceeding. It seems only reasonable to counsel for petitioner that if the presumption of correctness is a presumption of law, then whether the proceeding arise in a District Court or a Tax Court, the general principle must apply that a presumption of law disappears when met by sufficient evidence contrary to the presumption, and then that the case must stand upon all the evidence.

The Supreme Court of the United States has not, to the knowledge of counsel for petitioner, ever expressed its opinion with regard to the nature of the presumption of correctness of findings by the Bureau of Internal Revenue. It is either a presumption of fact or it is a presumption of law. The opinion of the Court of Appeals in the instant case indicates that that Court believes it is a presumption of fact.

In the instant case, the fundamental issue is whether 86% or 96.41% of petitioner's sales between July 1, 1943, and March 31, 1944, was distilled spirits sales. Petitioner has presented overwhelming evidence to support the 96.41% figure. Appellee offers no factual support of the 86% figure, merely urging its acceptance with the arbitrary contention that since it was petitioner's estimate, he cannot complain if it is used. Clearly, then, petitioner has by a preponderance of the evidence established the correctness of the 96.41% figure.

4. THE COURT OF APPEALS ERRED IN HOLDING THAT THE FRAUD PENALTY WAS SUSTAINED BY CLEAR AND CONVINCING EVIDENCE.

Fraud is not to be presumed, but must be determined from clear and convincing evidence considering all the facts and circumstances involved. *Jameson v. Commissioner,* (C.C.A. 5) 45 F. (2d) 4. The burden of proving fraud is on the Collector. *Griffiths v. Commissioner* (C.C.A. 7) 50 F. (2d) 782; *Budd v. Commissioner* (C.C.A. 3) 43 F. (2d) 509. Counsel for petitioner reiterates his position that with the substitution of the 96.41% figure for the 86% figure in the calculated inventory formula, petitioner has sustained the accuracy of his physical inventory and fully accounted for all the merchandise purchased by him prior to April 1, 1944.

Counsel for petitioner have conceded the propriety of the primary assessment on the two hundred cases of whisky moved from the warehouse on March 31, not because counsel agree that the finding is correct, but merely to avoid bringing a purely factual question before the Supreme Court of the United States. However, it is the opinion of counsel that a serious question of law arises as to the propriety of a fraud assessment based on the testimony of respondent's agent with regard to the truck movements on March 31, 1944. An analysis of that testimony reveals that the petitioner is not named once as having anything to do personally with the movement of the trucks, the drivers of the trucks have never been connected as agents or employees of petitioner, their names are not even dis-

closed, the agent speaks of seeing a truck at a warehouse loading cartons "resembling whisky cartons" (R. 246), yet there is no evidence that the agents ever made inquiry of the warehouse as to what said truck took therefrom. The large truck was never followed to any ultimate destination where whisky was removed, stored or concealed, but was lost in the traffic (R. 249), not one bottle of liquor was proved concealed. *Furthermore, the record is barren of any evidence showing that respondent's agents ever questioned petitioner with regard to the alleged movement of goods on March 31, 1944. One can only conclude that respondent was far more satisfied to end his investigation with his suspicions unconfirmed than he was to continue his investigation to an ultimate conclusion.*

In opinion of counsel for petitioner, the best that can be said of this testimony of respondent's agent is that it might serve as justification for further inquiry, but to say that this type of evidence establishes fraud by clear and convincing evidence is, in the opinion of counsel, a clear mistake of law.

CONCLUSION.

It is respectfully submitted that the Court of Appeals in this case was in error and that the entire fraud assessment in this case was therefore improper and that the primary assessment was illegal except as

to the two hundred cases of whisky (412.8 proof gallons).

Dated, San Francisco, California,
May 2, 1951.

Respectfully submitted,
A. RUSSELL BERTI,
Attorney for Petitioner.

MORRIS M. GRUPP,
LEON SCHILLER,
Of Counsel.